No. 7724

In the United States Circuit Court of Appeals for the Ninth Circuit

COMMISSIONER OF INTERNAL REVENUE, PETITIONER

v.

CORINNE S. KOSHLAND, RESPONDENT

ON PETITION FOR REVIEW OF DECISION OF THE UNITED STATES BOARD OF TAX APPEALS

BRIEF FOR THE PETITIONER

FRANK J. WIDEMAN,
Assistant Attorney General.

SEWALL KEY,
JOHN MacC. HUDSON,
Special Assistants to the Attorney General.

INDEX

CITATIONS

In the United States Circuit Court of Appeals for the Ninth Circuit

No. 7724

Commissioner of Internal Revenue, petitioner

v.

Corinne S. Koshland, respondent

ON PETITION FOR REVIEW OF DECISION OF THE UNITED STATES BOARD OF TAX APPEALS

BRIEF FOR THE PETITIONER

OPINION BELOW

The only previous opinion is the unreported memorandum opinion of the United States Board of Tax Appeals (R. 25–32).

JURISDICTION

This appeal involves income taxes in the amount of $330.98 for the year 1930 and is taken from a decision of the United States Board of Tax Appeals entered May 14, 1934 (R. 32–33). The case is brought to this Court by petition for review filed on August 2, 1934 (R. 33–40), pursuant to

Sections 1001–1003 of the Revenue Act of 1926, c. 27, 44 Stat. 9, as amended by Section 1101 of the Revenue Act of 1932, c. 209, 47 Stat. 169, as amended by Section 519 of the Revenue Act of 1934, c. 277, 48 Stat. 680.

QUESTIONS PRESENTED

1. Was the common stock distributed by a corporation to the taxpayer as a dividend upon her preferred stock a nontaxable stock dividend or a property dividend subject to taxation?

2. Is the taxpayer, having failed to report the common stock as a property dividend for income taxation in the years of receipt, estopped to assert in a later year when the preferred stock was redeemed that such was a taxable dividend with no effect upon the cost of the preferred stock in respect of which the dividend was received?

STATUTES AND REGULATIONS INVOLVED

The statutes and regulations involved are set forth in the Appendix, *infra*, pp. 28–31.

STATEMENT

The taxpayer, a resident of San Francisco, California, was a stockholder in the Columbia Steel Corporation, a Delaware corporation organized in November 1922, with an authorized capital stock of 100,000 shares of preferred par value $100 each, and 1,000,000 shares of common, originally $10 par value each but by charter amendment of no par value (R. 25, 44, 59, 61, 63). At or about the time of organization the corporation acquired from W. E. Creed certain properties in exchange for 39,918.42 shares of its preferred and 547,500 shares of its common stock, to be issued to W. E. Creed or his nominees (R. 25, 45, 97–99). The additional preferred stock of the corporation was offered to the public at par (R. 26, 100) and Creed offered to certain prospective purchasers of the preferred stock five shares of the common stock allotted to him for each share of preferred purchased from the corporation (R. 26). No common stock was sold by the corporation (R. 45). Under the offer by Creed, the taxpayer subscribed for 150 shares of preferred stock at par, paying therefor $15,000, with the understanding she also would receive therefor 750 shares of common stock (R. 26, 45). The taxpayer in 1924 paid the $15,000 to the corporation and received therefor 150 shares of preferred and 750 shares of common stock (R. 42, 44).

Dividends on the preferred stock were payable at 7 percent a year or during the first five years in the discretion of the directors at the rate of one share of common stock for each share of preferred. Dividends accruing after five years could not be paid in common stock. At any time within five years after incorporation the preferred stock was convertible into common stock at the rate of ten shares of common for each share of preferred.

After five years the preferred was redeemable at $105 a share plus unpaid accrued dividends. The preferred stock had no voting privileges (R. 26, 89).

As authorized, the directors of the corporation by resolutions duly adopted declared, and there was paid, a dividend upon the preferred stock in each of the years 1925, 1926, and 1927 of one share of common stock for each share of preferred, and in the year 1928 of one-half share of common stock and $3.50 in cash for each share of preferred. In each of the years the surplus of the corporation exceeded the amount of a 7 percent cash dividend on the preferred and upon issuance of the common stock as a dividend each year it was charged to surplus at the rate of $7 a share and credited to dividends payable in the same amount. Corresponding book entries were made of like amounts crediting common stock and charging dividends payable (R. 26, 50–52, 66, 73, 76, 81–82).

In January 1926, the corporation offered its stockholders of record the right to subscribe for a specified number of shares of preferred and common stock in units of one share of preferred and 50 shares of common stock at $300 a unit, and pursuant thereto the taxpayer purchased from the corporation 15 units, 15 shares of preferred and 750 shares of common (R. 26–27, 54–56, 58, 71–72).

As the owner of preferred stock the taxpayer received dividends of common stock thereon as follows (R. 27, 59):

Jan. 1925	127 shares common stock
Jan. 1926	150 shares common stock
Jan. 1927	165 shares common stock
Jan. 1928	82½ shares common stock

No amount was reported by the taxpayer as income from such dividends on her tax returns for the respective years (R. 59).

In 1930 the 165 shares of preferred stock then owned by the taxpayer were redeemed by the corporation and she received therefor $17,325 (R. 27).

The Commissioner determined that the prices paid by the taxpayer upon the respective purchases in 1924 and 1926 were for preferred and common stock together as a block or unit, and accordingly allocated the cost on each purchase to the respective classes of stock according to their values. The Commissioner further determined that the dividends of common stock in 1925 to 1928, inclusive, were nontaxable stock dividends, and accordingly the cost of the preferred stock in respect of which the dividends were paid was apportioned to the two classes of stock on the basis of their respective values at the time the dividends were received. Thus the true cost basis of the preferred stock held and redeemed in 1930 was fixed for determination of the gain realized on the redemption of such stock. In accordance therewith the Commissioner determined a deficiency in tax for 1930 of $833.48 (R. 13, 22).

128367—35——2

SPECIFICATION OF ERRORS TO BE URGED

The Board of Tax Appeals erred:

1. In holding that the common stock received by the taxpayer during 1925 to 1928, inclusive, as a dividend on preferred stock was not a stock dividend.

2. In holding that the taxpayer is not estopped to deny that the common stock received by her during 1925 to 1928, inclusive, as a dividend on preferred stock was a stock dividend.

SUMMARY OF ARGUMENT

I

If the dividend paid to the taxpayer, a preferred stockholder, in common stock was nontaxable at the time of distribution under Section 115 (f) of the Revenue Act of 1928 and Section 201 (f) of the Revenue Act of 1926, the Commissioner properly spread the cost of the old preferred over both the preferred and the common in proportion to their respective market values and properly computed the taxable gain on the redemption of the preferred stock in 1930. The real question is whether the distribution of the common stock was nontaxable at that time. This is merely a question of statutory construction and there is no need to determine whether the distribution was constitutionally immune from taxation.

The general meaning of the phrase "stock dividend" connotes any dividend paid by a corporation by a distribution of its theretofore unissued stock. There is no occasion to limit the meaning of the term to such a particular kind of stock dividend as may be exempt for constitutional reasons. If the term is ambiguous, the doubts is resolved in favor of the Commissioner's position by the administrative interpretation and the fact that the provision of the statute has been reenacted without change since its inception in the Revenue Act of 1921.

II

If it be considered that the common stock issued to the taxpayer as a dividend upon preferred was not a true stock dividend, the taxpayer should now be estopped to assert the fact and to deny that the Commissioner properly treated the same as a stock dividend, apportioning the cost of the preferred to the respective classes of stock. During the years in which the common stock was received as dividends the taxpayer reported on her returns no amount as income on account thereof. The statute declares that all dividends other than stock dividends are taxable income and requires the taxpayer to report the same on the return for the year in which received. By failing to report the common stock as taxable dividends the taxpayer represented that the same were not taxable but were stock dividends. The Commissioner accepted the returns as made at least in this respect and determined the tax liability for each of the respective years on that basis. The taxpayer should not now be heard to say that the common stock received was taxable as dividends in the year in which received and was not stock dividends.

ARGUMENT

I

The common stock received by taxpayer as dividend on preferred stock was a nontaxable stock dividend

The Board of Tax Appeals sustained the ruling of the Commissioner that the preferred and common stock acquired by the taxpayer in 1924 and 1926 were purchased in blocks or units of both preferred and common and the price paid therefor represented the cost of both classes, necessitating an apportionment of the aggregate cost to the respective classes to fix the correct basis for determining the gain or loss on a sale of each class of stock. The Board held, however, that the common stock issued as a dividend on the preferred were property dividends and not stock dividends and hence no part of the cost of the preferred may be allocated to the common stock issued thereon.

That the price paid by the taxpayer for the preferred stock in 1924 and 1926 represented in part the cost of the common stock acquired therewith seems plain. The taxpayer subscribed for 150 shares of preferred in 1924 on the understanding she would receive five shares of common with each share of preferred. The mere fact that the common stock was issued to her out of the lot set apart for Creed as part consideration for certain properties is not material. It is obvious that Creed was principally interested in the corporation and the common stock set apart as his was for practical purposes deemed available to the corporation for issuance as an inducement to purchases of preferred stock. In practical effect the taxpayer purchased from the corporation 150 shares of preferred and 750 shares of common stock at the rate of $100 for one share of preferred and five shares of common stock, a total of $15,000. In 1926 the corporation expressly offered its preferred and common stocks for sale in units of one preferred and 50 common shares and not separately. The taxpayer bought 15 such units, and not 15 shares of preferred separately. Accordingly, it is clear that the price paid for the stocks in 1924 and 1926 represented the cost of both the preferred and the common stock then received and not of either class of stock alone.

It is equally clear that under such circumstances the total price paid for preferred and common stock as a unit must be apportioned and allocated to the respective classes of stock to fix the proper cost basis of each class. This the Commissioner did in proportion to the market value of each class of stock and the Board approved that action. The taxpayer does not dispute the value of the preferred and common stock as fixed by the Commissioner. The purchase of two classes of stock for an aggregate price is not unlike the exchange in a corporate reorganization of one class of old stock for two classes of new stock. In the latter case, no gain or loss being recognized on the exchange, the cost of the old stock is substituted as the cost of both classes of new stock (Revenue Act of 1928, c. 852, 45 Stat. 791, Sections 112 (b) (3) and 113 (a) (6)) and it is well recognized that such cost must be apportioned to the respective classes of new stock to fix the correct cost of each class and that the fair market value of the new stock is a proper basis of apportionment. *Houghton* v. *Commissioner,* 71 F. (2d) 656 (C. C. A. 2d), certiorari denied, 293 U. S. 608; *Curtiss* v. *Commissioner,* 57 F. (2d) 847 (C. C. A. 5th); *Kirkland* v. *Burnet,* 57 F. (2d) 608 (App. D. C.); *Griffiths* v. *Commissioner,* 70 F. (2d) 946 (C. C. A. 7th); *Collin* v. *Commissioner,* 32 F. (2d) 753 (C. C. A. 6th). This is so because the cost of the old stock represents the investment in or cost of both classes of new stock and not of either class of new stock to the exclusion of the other. Similarly, the aggregate price paid for the preferred and common stock here represents the cost of both and not of one to the exclusion of the other; hence apportionment of the total price is essential to fix the cost of each kind of stock.

Thus we come to the only question to be considered here.,The Board of Tax Appeals having sustained the Commissioner in apportioning the cost to the preferred and common stock purchased, we are concerned here only with whether the common stocks issued as dividends on the preferred were truly nontaxable stock dividends or were, as held by the Board of Tax Appeals, property dividends taxable as other dividends. If the Board correctly held that such dividends were not stock dividends then there can be no apportionment and allocation of the cost of the preferred stock to the common stocks received as dividends thereon. In that case the common stock represents taxable dividends to the extent of the market value when received and such market value becomes the cost basis of the common stock for determining the gain or loss on a subsequent disposition thereof. If, however, the common stocks truly represent stock dividends no income was derived upon the receipt thereof and they are not taxable at that time, since they are only additional evidences of the taxpayer's investment or interest in the corporation. But in that case the cost of the preferred stock in respect of which the common stock was issued must be fairly apportioned and a part thereof allocated to the common stock, and a fair basis of apportionment is the market value of the respective stocks at the time of issuance of the dividend. Inasmuch as the common stock is received because of ownership of the preferred and both together, and not either to the exclusion of the other, represents the aggregate investment, it is essential, as in the case of the nontaxable exchanges above noted, to allocate a fair proportion of the cost of the preferred to the common stock so that the true cost basis of both may be fixed for determination of the actual gain or loss on a subsequent disposition of either class of stock.

The statute (Section 115 (f), *infra*) in declaring that a *stock dividend* shall not be subject to tax does not undertake to define the term, but it will be observed that the Regulations of the Treasury (Article 628, *infra*) provide generally that the issuance of its own stock by a corporation as a dividend to its shareholders does not result in taxable income. We submit that the regulations are consistent with the statute and that the statute as interpreted by the regulations treats any issue by a corporation of its own stock as a dividend to its stockholders as a *stock dividend* and not a taxable property dividend. It follows necessarily, as we have shown above, that the cost of the stock in respect of which such a stock dividend is paid must be apportioned and a part allocated to the dividend stock. The regulations, indeed, expressly so provide. Articles 58, 600, 628, *infra*.

The Board of Tax Appeals in holding, on authority of *Tillotson Manufacturing Co.* v. *Commissioner,* 27 B. T. A. 913, affirmed by the Circuit Court of Appeals for the Sixth Circuit on March 14, 1935, that the common stock received by the taxpayer as a dividend on preferred stock were not true stock dividends relied upon some of the reasoning in *Eisner* v. *Macomber,* 252 U. S. 189, holding that a stock dividend may not constitutionally be taxed as income. There the Court pointed out that a stock dividend does not alter the preexisting proportionate interest of the stockholder but merely increases the number of shares evidencing such interest *with consequent dilution of the value* of each share; in other words, that the proportionate interest of the stockholder remains the same as before the issuance of the new shares. The Board thought that since the issuance of common stock as a dividend on preferred stock, because of inherent differences in the two kinds of stock, does alter the preexisting proportionate interest of the stockholder it cannot properly be deemed a stock dividend as defined in *Eisner* v. *Macomber, supra.*

While in the *Macomber* case the stock was all of the one class, comon stock, it should be noted that the Court in considering the essential character of a stock dividend not only referred to the effect upon the *proportionate* interest of the stockholder but emphasized the fact that the aggregate assets of the corporation are not affected and the stockholder thereby receives none of the corporate assets. After discussing the relation of the stockholder to the corporation and the necessities of corporate activities requiring the use of surplus profits in the business, instead of distributing the same as dividends, in which event the amount of profits retained are charged to surplus, credited to capital stock and

128367—35——3

stock for that amount issued pro rata to the stockholders, the Court said (pp. 210–211):

> This, however, is merely bookkeeping that does not affect the aggregate assets of the corporation or its outstanding liabilities; it affects only the form, not the essence, of the "liability" acknowledged by the corporation to its own shareholders, and this through a readjustment of accounts on one side of the balance sheet only, increasing "capital stock" at the expense of "surplus"; it does not alter the preexisting proportionate interest of any stockholder or increase the intrinsic value of his holding or of the aggregate holdings of the other stockholders as they stood before. The new certificates simply increase the number of the shares, with consequent dilution of the value of each share.
>
> A "stock dividend" shows that the company's accumulated profits have been capitalized, instead of distributed to the stockholders or retained as surplus available for distribution in money or in kind should opportunity offer. Far from being a realization of profits of the stockholder, it tends rather to postpone such realization, in that the fund represented by the new stock has been transferred from surplus to capital, and no longer is available for actual distribution.
>
> The essential and controlling fact is that the stockholder has received nothing out of the company's assets for his separate use and benefit; on the contrary, every dollar of his

> original investment, together with whatever accretions and accumulations have resulted from employment of his money and that of the other stockholders in the business of the company, still remains the property of the company, and subject to business risks which may result in wiping out the entire investment. Having regard to the very truth of the matter, to substance and not to form, he has received nothing that answers the definition of income within the meaning of the Sixteenth Amendment.

If it be assumed that the issuance of the common stock to the taxpayer as a dividend on her preferred stock did alter the *proportionate* interest she held in the corporation and its assets, the fact remains that there was no severance of the corporation's assets and the taxpayer thereby received none of the assets. The accumulated earnings of the corporation were not distributed, but on the contrary were retained in the business. The taxpayer's investment in the corporation remains the same, there has been no severance of the fruits of her investment to distribution thereof to her. There has been only an increase of the evidences of her investment; true to some extent different in form, yet her entire original investment, together with the accretions thereto remain in the corporation with that of other stockholders subject to the risks of the business which might wipe out the entire investment. We submit that the common stock received by the taxpayer as a dividend on preferred stock may properly be treated as a stock dividend, under the *Macomber* case, which resulted only in a dilution of the value of her preferred stock. Both the common stock and the preferred stock represented her investment and a portion of the cost of the latter must be allocated to the common stock.

The reference in the *Tillotson* case, both by the Board and the Circuit Court of Appeals, to *Peabody* v. *Eisner,* 247 U. S. 347; *United States* v. *Phellis,* 257 U. S. 156; *Marr* v. *United States,* 268 U. S. 536; and *Weiss* v. *Stearn,* 265 U. S. 242, is not determinative, if in point. The first three held the distributed stock taxable as dividends on the ground that it was not the distributing corporations own stock or the two corporations were not substantially identical, so that the stockholder received a segregated part of his corporation's assets or a new and entirely different interest from what he held before. In the last case the stock distributed was held nontaxable as a dividend on the ground of the substantial identity of the corporations, so that the stockholder's interest remained the same after as before the distribution. Of, course, where a corporation distributes the stock of another corporation as dividends, it thereby distributes a part of its assets. Such a distribution is not a stock dividend which in nowise affects the aggregate assets of the corporation. Such cases have no application here. *Eisner* v. *Macomber, supra,* (p. 215).

If it should be considered that under the *Macomber* case a stock dividend is essentially one which does not alter the *proportionate* interest of the stockholder in the corporation, still the dividend here involved is a stock dividend for the purposes of the statute. It must be remembered that the *Macomber* case was concerned solely with the constitutional *power* of Congress to tax a dividend in stock as income to the stockholder, the case having arisen under the statutes prior to the Revenue Act of 1921 which taxed all dividends as income. The Court held that a dividend by a corporation in its own stock is not income under the constitutional amendment, because among other things the *proportionate* interest of the stockholder was not altered. As a result of that decision all Revenue Acts beginning with the 1921 Act have expressly declared stock dividends not taxable. The words of the statute, however, are broad and unambiguous, that all stock dividends are not subject to tax, and we submit there is no reason to assume that the relief from taxation is restricted to the limited class of stock dividends which are constitutionally exempt from income taxation. The words of the statute should be given their plain and generally accepted meaning.

We submit that the phrase "stock dividend" given its generally accepted meaning refers to any dividend paid by a corporation by a distribution of its theretofore unissued stock and is not limited to a distribution which actually preserves without any change the stockholders' proportionate interest in the corporation. So Black's Law Dictionary, 2d Ed., p. 383, defines a stock dividend as "One paid in stock, that is, not in money, but in a proportional number of shares of the capital stock of the company, which is ordinarily increased for this purpose to a corresponding extent." The following statement is contained in 14 Corpus Juris, p. 812, Section 1234 f: "A dividend made payable by a corporation in new or unissued shares of its own stock is a stock dividend." Thompson on Corporations, 3d Ed., Vol. 7, p. 137, Section 5263, states: "A stock dividend is what the term itself implies, a distribubution of the stock of the corporation among the stockholders as a dividend."

If there should be a real doubt whether the phrase embraces generally all dividends paid in unissued corporate stock as distinguished from other forms of property, we believe such doubt is resolved by the administrative construction of the provision. The Commissioner, with the approval of the Secretary, is empowered to prescribe all needful rules and regulations for the enforcement of the Revenue Acts. Revenue Act of 1928, Section 62; Revenue Act of 1926, c. 27, 44 Stat. 9, Section 1101 (U. S. C. App., Title 26, Sec. 1245). He has consistently provided in regulations issued since the Revenue Act of 1921 that stock dividends within the meaning of the exemption do not include dividends paid by a corporation in securities other than its own stock but do include the issuance of its own stock by a corporation as a dividend to its shareholders. No such limitation as that now suggested is embodied in the regulations. Articles 1547 and 1548, Regulations 69; Articles 1547 and 1548, Regulations 62 and 65; Articles 627 and 628, Regulations 74 and 77.

The Income Tax Unit has specifically held that common stock paid as a dividend to preferred stockholders is nontaxable. I. T. 2538, IX–1 Cumulative Bulletin 144. Even if the statute is thought to be ambiguous the administrative interpretation is entitled to great weight and must be held valid where not unreasonable or plainly inconsistent with the statute. *Fawcus Machine Co.* v. *United States,* 282 U. S. 375, 378; *Brewster* v. *Gage,* 280 U. S. 327, 336; *Maryland Casualty Co.* v. *United States,* 251 U. S. 342, 347. Moreover, the reenactment of the statutory provisions without change is persuasive evidence of legislative approval. *Old Mission Portland Cement Co.* v. *Helvering,* 293 U. S. 289; *United States* v. *Dakota-Montana Oil Co.,* 288 U. S. 459, 466; *McCaughn* v. *Hershey Chocolate Co.,* 283 U. S. 488, 492–493; *Brewster* v. *Gage, supra,* p. 337.

Commissioner v. *Tillotson Mfg. Co.* (C. C. A. 6th), decided March 14, 1935, not yet reported but see C. C. H., 1935, Vol. 3, p. 9645, affirming 27 B. T. A. 913, is contrary to the contention here made. That case, however, may be distinguished on the ground that there the stock was issued to pay accumulated cash dividends in arrears and the stockholder was not compelled to accept the stock in satisfaction, but could await such time as the corporation had funds to pay in cash. In the instant case, the taxpayer had no election. The corporation was authorized to pay the dividend in its own stock and elected to do so. The taxpayer had no choice but to accept the common stock as the dividend on her preferred. That is all her preferred stock entitled her to, when the corporation decided to issue stock and not pay cash as a dividend.

It is a matter of conjecture whether the Commissioner's interpretation of Section 115 (f) will operate generally to the advantage of the taxpayer or of the Government. It aids the Government in this particular case. But if the Board is correct and the distribution is taxable when made, then every individual taxpayer similarly situated would be taxable for surtax purposes at the time when the stock is received; whereas under our contention the tax is postponed until a later sale or disposition when, because of fluctuation in value, no taxable income may possibly be derived. So for the purposes of the revenue it is largely a matter of indifference which interpretation of the statute is adopted. However, in view of the plain terms of the statute and the provisions of the regulations, it is submitted that it is more logical to construe Section 115 (f) of the Act as exempting this and similar distributions from tax at the time they are made.

II

The taxpayer is estopped to deny that the common stock received as a dividend on preferred was a stock dividend

If the Court should be of the opinion that the common stocks received as dividends on preferred stock were in fact stock dividends, then under the circumstances of this case, we submit, the taxpayer is estopped to assert the fact to avoid the tax upon the true gain resulting from the disposition of the preferred stock in a later year. If the common stocks were not received as stock dividends within the meaning of the statute, they were properly dividends and taxable income in the years in which they were received and the statute required that the taxpayer report such income on her tax returns. Sections 201 (a) (b), 213 (a), Revenue Act of 1926, c. 27, 44 Stat. 9 (U. S. C. App., Title 26, Secs. 932, 954). The taxpayer, however, did not include in her returns for the years 1925 to 1928, inclusive, any amount on account of the common stocks received as dividends during those years (R. 59).

The returns as made, in this respect, by the taxpayer from 1925 to 1928 were accepted by the Commissioner and by failing to report thereon the dividends in common stock the taxpayer represented that no taxable dividends on her preferred stock had been received. She should not now be heard to say that the dividends in common stock were taxable dividends in the years of receipt and not nontaxable stock dividends, as she impliedly represented, when the result is to defeat the proper apportionment of the preferred stock cost and the tax upon the true gain realized on the redemption of the preferred stock in 1930. A party cannot, having represented a state of things to exist and led others to rely thereon, deny the fact and assume an inconsistent position. See *Casey* v. *Galli,* 94 U. S. 673, 680; *Morgan* v. *Railroad Co.,* 96 U. S. 716, 720; *Central Pacific Railroad* v. *California,* 162 U. S. 91, 113–114.

This doctrine has often been applied under varying circumstances in tax cases. In *Stearns Co.* v. *United States,* 291 U. S. 54, the Court said (pp. 61–62):

> The applicable principle is fundamental and unquestioned. "He who prevents a thing from being done may not avail himself of the nonperformance which he has himself occasioned, for the law says to him in effect 'this is your own act, and therefor you are not damnified.'" * * * Sometimes the resulting disability has been characterized as an estoppel, sometimes as a waiver. The label counts for little. Enough for present purposes that the disability has its roots in a principle more nearly ultimate than either waiver or estoppel, the principle that no one shall be

> permitted to found any claim upon his own inequity or take advantage of his own wrong. * * * A suit may not be built on an omission induced by him who sues.

In *Askin & Marine Co.* v. *Commissioner,* 66 F. (2d) 776 (C. C. A. 2d), the taxpayer, conceding that a deduction for bad debts in 1920 was properly disallowed by the Commissioner because the debts were not ascertained to be worthless in that year, contended that the collections in 1920 of amounts similarly charged off in earlier years and allowed as deductions, although not ascertained to be worthless in the year of charge-off, could not be included in its income for 1920. The court, denying the contention, said (p. 778):

> Having represented that it had ascertained these accounts charged off its active file to be worthless and having received the benefit of the deduction it claimed when the commissioner took its representation of the ascertainment of worthlessness at its face value, we think the petitioner is now clearly estopped from denying, to the prejudice of the government, the truth of the representations upon which it has succeeded in former years in obtaining deductions from its gross income. While the commissioner must investigate returns to satisfy himself of their correctness in fact and law, a taxpayer may not benefit at the expense of the government by misrepresenting facts under oath; by succeeding in having the commissioner accept its representations as the truth; and

> by claiming later that what it represented to be true might have been found false had the commissioner refused to have faith in the sworn return. * * *

In *Haag* v. *Commissioner,* 59 F. (2d) 514 (C. C. A. 7th), the taxpayer having in her tax return represented that she was a member of a certain partnership, which in its return made like representations, she was held estopped to deny that she was a partner and taxable upon her share of partnership income. The court there said (p. 515):

> Having represented under oath to the Government that she was a member of the partnership and the Government having accepted her representation and acted accordingly, she cannot be heard to deny that status after the time had passed for the Government to validly assess a tax against the estate. * * *

In *Hartwell Mills* v. *Rose,* 61 F. (2d) 441 (C. C. A. 5th), it was held that the taxpayer could not contend that certain assessments were void. The court said that taxation is a practical matter having to do with matters which ought to be, and normally are, disposed of informally; that where rights have been substantially preserved, proceedings will not be defeated by defects in form. The court then said (p. 444):

> Especially is it true that, where the government and the taxpayer, by acquiescence in the manner of performing an act, have given a definite character and effect to it, the tax-

> payer will not be permitted, after deriving benefits from this acquiescence, to deny this character and effect to it, or to change his position at the government's expense.

Swartz, Inc., v. *Commissioner,* 69 F. (2d) 633 (C. C. A. 5th), held that the taxpayer and its sole stockholder, having returned the income from a contract assigned by the stockholder to the taxpayer as income of the corporation, were estopped from asserting that the stockholder individually, and not the taxpayer, was the real owner of the income. *Walker* v. *Commissioner,* 63 F. (2d) 346, 349 (C. C. A. 5th), held that the taxpayer having reported as income in his returns for 1921, 1922, 1923, and 1924 amounts received in those years and the Commissioner having accepted the returns as a basis of computing the tax liability, the taxpayer was estopped to claim that the amounts received and reported for 1923 and 1924 were income for 1921 and 1922 when his right thereto accrued.

Crane v. *Commissioner,* 68 F. (2d) 640, 641 (C. C. A. 1st), held that the taxpayer having failed to report as income on his returns for the year in which made, the value of improvements constructed by his lessee, he could not increase the cost basis of the property by the depreciated value of the improvements for the purpose of determining the gain or loss on the subsequent sale of the property. See also *Moran* v. *Commissioner,* 67 F. (2d) 601 (C. C. A. 1st); *Continental Products Co.* v. *Commissioner,* 66 F. (2d) 434 (C. C. A. 1st); *Burnet* v.

San Joaquin Fruit & Investment Co., 52 F. (2d) 123 (C. C. A. 9th); *Commissioner* v. *Garber,* 50 F. (2d) 588 (C. C. A. 9th); *Commissioner* v. *Moore,* 48 F. (2d) 526 (C. C. A. 10th), certiorari denied, 284 U. S. 620; *Lucas* v. *Hunt,* 45 F. (2d) 781 (C. C. A. 5th); *Naumkeag Steam Cotton Co.* v. *United States,* 2 Fed. Supp. 126 (C. Cls.); *Ralston Purina Co.* v. *United States,* 58 F. (2d) 1065 (C. Cls.); *Rockwood* v. *United States,* 38 F. (2d) 707 (C. Cls.); *McDonald Coal Co.* v. *Heiner,* 9 F. (2d) 992 (W. D. Pa.).

The taxpayer having omitted on her returns any amount for the common stock as taxable dividends in the years of receipt represented that they were not taxable dividends but were stock dividends. Those returns were accepted by the Commissioner. The taxpayer should not now be heard to say that the shares of common stock were taxable dividends when received and not stock dividends which proportionately reduced the cost of the preferred stock in respect of which they were issued, so that the taxable gain on the later disposition of the preferred must be measured by the original cost without regard to the common stock received free from tax. See *Crane* v. *Commissioner, supra; Askin & Marine Co.* v. *Commissioner, supra; Haag* v. *Commissioner, supra; Swartz, Inc.,* v. *Commissioner, supra; Walker* v. *Commissioner, supra.*

CONCLUSION

The decision of the Board of Tax Appeals is erroneous and should be reversed with instructions to enter judgment for the Commissioner.

Respectfully submitted.

Frank J. Wideman,
Assistant Attorney General.
Sewall Key,
John MacC. Hudson,
Special Assistants to the Attorney General.

April 1935.

APPENDIX

Revenue Act of 1928, c. 852, 45 Stat. 791:

> SEC. 115. DISTRIBUTIONS BY CORPORATIONS. (a) *Definition of dividend.*—The term "dividend" when used in this title (except in section 203 (a) (4) and section 208 (c) (1), relating to insurance companies) means any distribution made by a corporation to its shareholders, whether in money or in other property, out of its earnings or profits accumulated after February 28, 1913.
>
> * * * * *
>
> (f) *Stock dividend.*—A stock dividend shall not be subject to tax.
>
> * * * * *

Section 201 (a) (f) (U. S. C. App., Title 26, Sec. 932), Revenue Act of 1926, c. 27, 44 Stat. 9, and, so far as material here, Section 201 (a) (f) (U. S. C., Title 26, Sec. 932), Revenue Act of 1924, c. 234, 43 Stat. 253, are substantially the same as the Section above quoted.

Treasury Regulations 74:

> ART. 58. *Sale of stock and rights.*— * * * In the case of stock in respect of which any stock dividend was paid, the basis for determining gain or loss from a sale of a share of such stock shall be ascertained in accordance with the principles laid down in article 600. Where common stock is received as a bonus with the purchase of preferred stock or bonds, the total purchase

price shall be fairly apportioned between such common stock and the securities purchased for the purpose of determining the portion of the cost attributable to each class of stock or securities, but if that should be impracticable in any case, no profit on any subsequent sale of any part of the stock or securities will be realized until out of the proceeds of sales shall have been recovered the total cost.

ART. 600. *Stock or securities distributed in reorganization.*—In the case of stock or securities acquired by a shareholder after December 31, 1923, in connection with a transaction described in section 112 (g) of article 576, the basis in the case of the stock in respect of which the distribution was made shall be apportioned between such stock and the stock or securities distributed to the shareholder. The basis for the old and new shares shall be determined in accordance with the following rules:

(1) Where the stock distributed in reorganization is all of substantially the same character or preference as the stock in respect of which the distribution is made, the basis of each share will be the quotient of the cost or other basis of the old shares of stock divided by the total number of the old and new shares.

(2) Where the stock distributed in reorganization is in whole or in part of a character or preference materially different from the stock in respect of which the distribution is made, the cost of other basis of the old shares of stock shall be divided between such old stock and the new stock in proportion, as nearly as may be, to the respective values of each class of stock, old and new, at the time the new shares of stock are dis-

tributed, and the basis of each share of stock will be the quotient of the cost or other basis of the class with which such share belongs, divided by the number of shares in the class.

(3) Where the stock in respect of which a distribution in reorganization is made was purchased at different times and at different prices, and the identity of the lots cannot be determined, any sale of the original stock will be charged to the earliest purchases of such stock (see article 58), and any sale of the stock distributed in reorganization will be presumed to have been made from the stock distributed in respect of the earliest purchased stock.

(4) Where the stock in respect of which a distribution in reorganization is made was purchased at different times and at different prices, and the stock distributed in reorganization cannot be identified as having been distributed in respect of any particular lot of such stock, then any sale of the stock distributed in reorganization will be presumed to have been made from the stock distributed in respect of the earliest purchased stock.

Art. 628. *Stock dividends.*—The issuance of its own stock by a corporation as a dividend to its shareholders does not result in taxable income to such shareholders, but gain may be derived or loss sustained by the shareholders from the sale of such stock. The amount of gain derived or loss sustained from the sale of such stock, or from the sale of the stock in respect of which it is issued, shall be determined as provided in articles 561 and 600.

The provisions of Treasury Regulations 65, promulgated under the Revenue Act of 1924, and

Treasury Regulations 69, promulgated under the Revenue Act of 1926 (Articles 39, 1548, and 1599), so far as material, are substantially the same as the above-quoted provisions of Treasury Regulations 74.

GOVERNMENT PRINTING OFFICE: 1935